

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Petition of Fairpoint	)	
Communications, Inc. for a	)	WT Docket No. 07-66
Waiver of the All-or-Nothing Rule	)	
In Connection with Its Acquisition	)	
Of Certain Verizon Properties in	)	
Maine, New Hampshire, and Vermont	)	

**Comments of  
Communications Workers of America and  
International Brotherhood of Electrical Workers**

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May 4, 2007

The Communications Workers of America (“CWA”) and the International Brotherhood of Electrical Workers (“IBEW”) urge the Commission to deny the Petition of Fairpoint Communications, Inc. (“Fairpoint”) for a waiver of the Section 61.41 “all-or-nothing” price cap rule in connection with its acquisition of certain Verizon properties in Maine, New Hampshire, and Vermont.<sup>1</sup> Granting the petition would allow Fairpoint to shift costs among affiliates so as to raise rates on consumers while increasing earnings, outcomes that the Commission’s rules are designed to prevent.

CWA and IBEW represent 1.45 million employees working in the wireline telecommunications, cable, wireless, broadcasting, construction and maintenance, government, utility, publishing, manufacturing, airlines, higher education, and other public and private sector organizations. The CWA and IBEW represent 2,800 workers employed by Verizon in Maine, New Hampshire and Vermont. We are vitally concerned with the outcome of this proceeding because our members and their families will be affected by the sale in terms of their interests as workers, consumers and residents.

Fairpoint has entered into an agreement with Verizon Communications Inc. (“Verizon”) to purchase Verizon’s approximately 1.5 million local access lines and certain other assets and long-distance relationships in Maine, New Hampshire, and Vermont. These lines are subject to price cap regulation. Fairpoint currently provides local exchange service to 308,000 access lines

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<sup>1</sup> Petition of Fairpoint Communications, Inc. for Waiver of Sections 61.41(b) and (c) of the Commission’s Rules, WC Docket No. 07-66, Feb. 21, 2007 (“Waiver Petition”); FCC Public Notice, Petition of Communications Inc., for a Waiver of the All-Or-Nothing Rules in Connection with Its Acquisition of Certain Verizon Properties in Maine, New Hampshire, and Vermont, WC Docket No. 07-66, April 4, 2007.

in 18 states, including 64,000 in Maine, New Hampshire, and Vermont. These lines are under rate-of-return regulation.

Fairpoint seeks a waiver of the Commission's Section 61.41 "all-or-nothing" price cap rules so that Fairpoint may continue to operate its existing exchanges under rate-of-return regulation after the transaction without converting them to price cap regulation as required by Section 61.41.

Section 61.41 of the Commission's rules provides that when any price cap company acquires, merges with, or otherwise becomes affiliated with a price cap company or any part thereof, the acquiring company becomes subject to price cap regulation and must file price cap tariffs within a year.<sup>2</sup> Under these rules, Fairpoint's acquisition of the Verizon exchanges would obligate Fairpoint to become subject to price cap regulation for both its existing and acquired exchanges.

In the *LEC Price Cap Reconsideration Order*, the Commission explained that section 61.41(c) is intended to address concerns regarding mergers and acquisitions. The Commission noted that absent the rule, a LEC might attempt to shift costs from its price cap affiliate to its non-price cap affiliate, allowing the non-price cap affiliate to charge higher rates to recover its increased revenue requirement, while increasing the earnings of the price cap affiliate.

This is precisely what Fairpoint would be able to do if the Commission grants the waiver. Fairpoint would have every incentive to shift costs from its newly-acquired Maine, New Hampshire, and Vermont affiliate to its legacy rate-of-return affiliates. Because the price cap

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<sup>2</sup> 47 C.F.R. §61.41(c)(2). See *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, 6821 (1990), Erratum, 5 FCC Rcd 7664 (Com. Car. Bur. 1990) ("*LEC Price Cap Order*"), modified on recon., Order on Reconsideration, 6 FCC Rcd 2637 (1991) ("*LEC Price Cap Reconsideration Order*").

affiliate's 1.5 million lines would dwarf the rate-of-return affiliates' 300,000 lines, this would create extraordinary opportunity and incentive to move costs onto the books of the rate-of-return affiliates. Moreover, since the newly-acquired Verizon lines are contiguous with Fairpoint's New England properties, the opportunities to shift costs across these affiliates would be particularly strong. The result would be precisely the outcome that the Section 61.41 rules aim to prevent. Non-price cap affiliates would be able to charge higher rates to recover the increased revenue requirement, while at the same time increasing the earnings of the price cap affiliate.

There is no Commission precedent to justify Fairpoint's waiver request. The Commission has never granted a petition that would allow an acquiring company to operate some affiliates under rate-of-return regulation and some affiliates under price caps. In virtually every case that Fairpoint cites in its Petition, the Commission granted a waiver that would convert an acquired price cap property to rate-of-return, with the result that all affiliates of the merged entity were regulated in the same way. In most of those instances, the acquiring rate-of-return rural company purchased a small number of lines from an existing price cap company. In virtually all cases, and in contrast to this instant transaction, the acquiring company had far more access lines than the number of lines it purchased. Most significant, there is simply no instance in which the Commission approved a waiver that would result in a partial-price cap/partial rate-of-return regime within the same holding company.

Most telling, in the *Aliant Merger Order*, the Commission rejected a proposal by commentator AT&T to allow the merged entity to operate a mixed regulatory regime. In that instance, rate-of-return Alltel sought a waiver to convert its newly-acquired Aliant price cap lines to rate-of-return. AT&T proposed as an alternative a mixed regulatory system, with structural

separation to ensure compliance. The Commission soundly rejected that proposal noting that “[s]tructural separation does not cure the incentive to shift costs; it only makes cost shifting detectable.” The Commission was not willing to assume the additional monitoring costs and administrative burdens required in a mixed regulatory regime, noting that these costs far outweighed any purported benefits of a dual regulatory system.<sup>3</sup>

Yet in this instant transaction, Fairpoint seeks a waiver that would permit exactly the mixed regulatory system that the Commission so firmly rejected in the *Alltel Order*. The Commission must reject Fairpoint’s waiver request in order to protect consumers.

In its Petition, Fairpoint also claims that allowing its legacy exchanges to remain under rate-of-return regulation would serve the public interest by ensuring adequate universal service support for those exchanges.<sup>4</sup> The Commission should reject such reasoning. In fact, Fairpoint has used the generous subsidies it receives from the Universal Service Fund (USF) as a cash cow to benefit shareholders at the expense of its customers. The Commission does not need to sustain Fairpoint’s high rate-of-return access charge regime in its legacy exchanges in order to ensure adequate universal service support while preventing any offsetting growth in Universal Service Fund subsidies. There is an alternative. Fairpoint could reduce the amount of dividends that it pays out to shareholders, an amount that is the highest in the industry.

In 2006, Fairpoint paid out \$55 million in dividends to shareholders. That same year it earned \$31 million in net income. In other words, Fairpoint paid out more in dividends than it earned in profits. Fairpoint was able to pay such high dividends in large part because of the

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<sup>3</sup> *In the Matter of ALLTEL Corporation*, Memorandum Opinion and Order, 14 FCC Rcd, 14205, 1999 WL (“*Alltel Order*”).

<sup>4</sup> Fairpoint Petition, p.10.

generous high-cost loop Universal Service Fund subsidies it receives, which totaled approximately \$20 million last year.<sup>5</sup>

Financial analysts use two ratios to calculate the dividends paid to shareholders as a portion of corporate earnings and market value. The first ratio is called the “payout ratio.” The payout ratio is determined by dividing net income by the total dividends paid out. Fairpoint’s payout ratio of 179 percent means that it paid out 79 percent more in dividends than it earned in net income. Fairpoint has the highest payout ratio among the mid-sized rural telecommunications companies, 22 times higher than CenturyTel, five times higher than Embarq, almost twice as high as Citizens, and 25 percent higher than Windstream.<sup>6</sup> (See Table below)

Financial analysts also use the “dividend yield” to evaluate how much a company pays out to shareholders in dividends. The dividend yield equals the share price divided by total dividends paid out. Fairpoint’s dividend yield of 8.6 percent is fourteen times higher than CenturyTel’s, twice as high as Embarq’s, and a third higher than that of Windstream and Citizens.<sup>7</sup> (See Table below)

	Forward Annual Div Yield	Trailing Annual Div Yield	Payout Ratio
Fairpoint	8.60%	8.40%	179%
Windstream	6.80%	7.70%	132%
Citizens	6.30%	6.30%	94%
Embarq	4.20%	2.50%	31%
CenturyTel	0.60%	0.50%	8%
Verizon	4.20%	7.40%	76%
AT&T	3.70%	3.60%	69%

Source: yahoo finance, May 3, 2007

payout ratio = dividends divided by net income

dividend yield = share price divided by dividend

<sup>5</sup> Fairpoint SEC Form 10-K for the year ended Dec. 31, 2006.

<sup>6</sup> Yahoofinance.com visited May 3, 2007.

Our purpose here is not to second guess Fairpoint's business model or capital strategy. Our point here is simply to refute Fairpoint's claim that allowing its legacy exchanges to maintain rate-of-return regulation is necessary to ensure adequate universal services support for those exchanges. If the Commission were to deny Fairpoint's waiver request and require Fairpoint to convert its legacy exchanges to price cap regulation, universal support would not necessary be "insufficient." Fairpoint could change its current high dividend policy, directing a greater share of earnings to service and investment.

In the CWA/IBEW Petition to Deny in the merger review proceeding, we demonstrate that Fairpoint is a highly leveraged company that will have great difficulty meeting the significantly greater dividend and debt commitments it has made while simultaneously investing enough capital to maintain current plant, improve service quality, set up entirely new operation, administrative and billing systems, hire more workers and expand broadband availability. The financial and operational risks involved in the proposed acquisition overwhelm any purported benefits.\* (See attached CWA/IBEW Petition to Deny)

In the context of this risky merger, it is especially important that the Commission deny Fairpoint's unprecedented request to waive Commission Section 61.41 rules. The Commission should not allow Fairpoint to operate a mixed regulatory system, creating incentive and opportunity to shift costs from rate-of-return affiliates to price cap affiliates. This would result in higher rates to recover increased revenue requirements on customers of rate-of-return affiliates,

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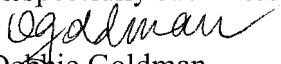
<sup>7</sup> *Id.*

<sup>8</sup> Petition to Deny of Communications Workers of America and International Brotherhood of Electrical Workers, In the Matter of Application for Transfer of Certain Verizon Spectrum Licenses in Maine, New Hampshire and Vermont to FairPoint, WC Docket No. 07-22, April 27, 2007.

and increased earnings by the price cap affiliate. As the Commission has pointed out, the additional administrative burden to safeguard consumers is not justified.

The Fairpoint purchase of Verizon's 1.5 million New England access lines is a bad deal for consumers. The Commission should deny Fairpoint's request in this instant proceeding

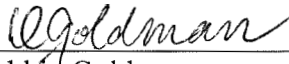
Respectfully submitted,

  
Debbie Goldman  
Research Economist  
Communications Workers of America

May 4, 2007

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing document was delivered by electronic mail, on this 4<sup>th</sup> day of May 2007 to the parties listed below.

  
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## DECLARATION OF DEBBIE GOLDMAN

My name is Debbie Goldman. I am Research Economist with the Communications Workers of America. My business address is 501 Third Street N.W., Washington, D.C. 2001.

The Communications Workers of America is a labor organization representing 700,000 workers, half of whom work in the communications industry, including wireline, wireless, Internet access, cable, broadcasting, and publishing.

The International Brotherhood of Electrical Workers is a labor organization representing 750,000 workers who work in a wide variety of fields, including utilities, construction, broadcasting, telecommunications, manufacturing, railroads and government.

Together, CWA and IBEW represent 2,800 Verizon workers in Maine, New Hampshire and Vermont.

I am familiar with the contents of the foregoing Reply Comments. The factual assertions made in the petition are true to the best of my knowledge and belief.

I declare under penalty of perjury that the foregoing is true and correct.  
Executed on May 4, 2007.



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Debbie Goldman